

STATE OF UTAH DEPARTMENT OF INSURANCE

Financial Examination of
Wasatch Crest Mutual Insurance Company
As of December 31, 2001

Examination Date: 12/31/01 Examiner(s): Robert C. Murphy, CFE, CIE

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STATE OF UTAH INSURANCE DEPARTMENT

REPORT OF EXAMINATION

OF

WASATCH CREST MUTUAL INSURANCE COMPANY

OF

SALT LAKE CITY, UTAH

**AS OF
DECEMBER 31, 2001**



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June 16, 2003

Honorable Alfred W. Gross, Chairman
NAIC Financial Condition (E) Committee
Insurance Commissioner
State of Virginia
Richmond, Virginia

Honorable John Morrison
Secretary, Western Zone NAIC
Director of Insurance
State of Montana
Helena, Montana

Honorable Merwin U. Stewart, Commissioner
Utah Insurance Department
State of Utah
Salt Lake City, Utah

Dear Sirs:

In accordance with your instructions and in compliance with the insurance laws of the State of Utah, an examination of the financial condition and business affairs of

WASATCH CREST MUTUAL INSURANCE COMPANY
Salt Lake City, Utah

hereinafter referred to as the "Company" or "WCM", was conducted as of December 31, 2001.

SCOPE OF EXAMINATION

The last examination was made as of December 31, 1998. The current examination covers the period from January 1, 1999 through December 31, 2001, including any material transactions and/or events occurring subsequent to the examination date noted during the course of the examination. The current examination was conducted under the authority granted the Commissioner by Utah Code Annotated (U.C.A.) §31A-2-203, and was conducted in accordance with the procedures set forth in the National Association of Insurance Commissioners (NAIC) Examiners Handbook which was also authorized by U.C.A. §31A-2-203(6)(c).

The examination included a general review and analysis of the Company's operations, the manner in which its business was conducted during the examination period, verification of the payment of premium taxes to the states in which it was licensed, and a determination of its financial condition as of December 31, 2001. Assets were verified and valued, and liabilities were determined or estimated in accordance with rules and procedures as prescribed by the State of Utah, the Company's state of domicile. The examination was conducted in accordance with the generally accepted standards and procedures of regulatory authorities relating to such examinations. It included tests of the accounting records and a review of the Company's affairs and practices to the extent deemed necessary.

The Company retained the services of Deloitte & Touche, a certified public accounting firm to audit its financial records for the years under examination. However, the firm did not begin the audit for 2001 until subsequent to the start date of the current examination and as a result, little reliance was placed in the work of the accounting firm.

The actuarial portion of the examination was performed by the consulting actuarial firm of Taylor-Walker & Associates, Inc. Their examination included a review of reserves for losses, loss adjustment expenses, unearned premiums, and reinsurance payable on projected losses.

A certificate of representation attesting to the Company's ownership of all assets and to the non-existence of unrecorded liabilities was signed by, and received from, the Company's management during the examination.

SUMMARY OF PRIOR EXAMINATION COMMENTS AND/OR RECOMMENDATIONS

The previous examination had the following six comments and/or recommendations. Following the individual examination report comment/recommendation is the status of the comment/recommendations.

- (1) There was a change in control of the Company's affiliates. (AFFILIATED COMPANIES)

Additional comments can be found under the HISTORY heading of this examination.

- (2) The Company's market conduct related operations were not in compliance with the provisions contained in the following: U.C.A. § 31A-23-219(1), § 31A-30-103; U.A.C. Rule R590-101-4, R590-130-10B, R590-130-9(c), R590-130-7(A)(2), R590-89-12.C, 590-89-11, R590-89-7.T, and R590-89-112.C. (INSURANCE PRODUCTS AND RELATED PRACTICES)

Territory and Plan of Operation - The previous examination noted that the Company was not in compliance with U.C.A. § 31A-23-219(1) and U.A.C. Rule R590-101-4, for failure to properly appoint agents prior to writing business on the Company's behalf. Additional comments may be found under the Territory and Plan of Operation heading of this examination.

Advertising and Sales Material - The previous examination noted that the Company was not in compliance with U.A.C. Rule R590-130-10(B), U.A.C. Rule R590-130-9(c), and R590-130-7(A)(2), which dealt with advertising and endorsement issues. Additional comments may be found under the Advertising and Sales Material heading of this examination.

Treatment of Policyholders – The previous examination noted the Company was not in compliance with R590-89-12.C, 590-89-11, R590-89-7.T, and R590-89-112.C, as they related to the settlement of claims and claim practices. Subsequent to the examination, the Company outsourced their medical claims to a third party administrator. Workers' compensation claims are now handled by LWP, Commercial Claim Administrators. Additional comments may be found under the Treatment of Policyholders heading of this examination report.

- (3) As of December 31, 1998, the Company's agreement with its investment custodian was not in compliance with Utah Administrative Code U.A.C. Rule R590-178. However, a new agreement dated May 3, 1999, was in compliance. (ACCOUNTS AND RECORDS)

The above mentioned custodial agreement remained in effect as of December 31, 2001.

- (4) Information provided by those responsible for maintaining the electronic data processing equipment and informational systems indicated that business mission critical systems and non-critical applications were Year 2000 compliant. (ACCOUNTS AND RECORDS)

There was no indication that the Company experienced any difficulties as a result of Year 2000.

- (5) The Company's minimum capital requirement was \$1,400,000 as defined in U.C.A. § 31A-5-211. As defined by U.C.A. § 31A-17 Part IV, the Company had total adjusted capital of \$5,418,357. This was in excess of the authorized control level risk-based capital requirement of \$2,543,043.

The Company filed the 2001 annual statement reflecting total adjusted capital of \$2,282,694, and authorized control level risk-based capital of \$1,223,931. This placed the Company at the Regulatory Action Level. Additional comments can be found under the CAPITAL AND SURPLUS heading of this examination report.

- (6) Subsequent Events were: Effective August 1, 1999, Gordon B. Boyle stepped down as president and Orrin T. Colby Jr. was named President and CEO. (MANAGEMENT AND CONTROL)

As of December 31, 2001, Orrin T. Colby Jr., was President and Chief Executive Officer of the Company.

The Company's certificate of authority was suspended in the State of Washington because its capital and surplus was less than that required by statute. (TERRITORY AND PLAN OF OPERATION)

As of December 31, 2001, the Company was suspended in the States of Washington and Idaho due to insufficient surplus as regards statutory limitations. Additional comments can be found under the TERRITORY AND PLAN OF OPERATION heading of this report.

The Utah Insurance Department was advised that a material loss event had occurred in that the cumulative net operating loss of the Wasatch Crest Group and its subsidiaries had exceeded \$3,000,000 on a GAAP accounting basis. (AFFILIATED COMPANIES)

Additional comments can be found under the HISTORY heading of this examination.

HISTORY

General

The Company was incorporated as Energy Mutual Insurance Company under the laws of the State of Utah as a mutual insurance company on September 30, 1976. The Company's articles of incorporation specified that the primary purpose of the organization was "[t]o engage in, render and transact all lines and forms of casualty insurance related lines of insurance business."

Effective April 15, 1994, the Company acquired all the outstanding shares of First Continental Life & Accident Insurance Company (FCL), a Utah Corporation.

Effective November 4, 1994, by amendment to its articles of incorporation, the name of the Company was changed from Energy Mutual Insurance Company to Wasatch Crest Mutual Insurance Company.

Effective January 1, 1997, the Company acquired all of the outstanding common stock of Transunion Casualty Insurance Company an Iowa domiciled property and casualty insurance company, from AUSA Holding Company. Effective January 1, 1998, Transunion Casualty Insurance Company acquired all of the outstanding stock of Wasatch Fire Insurance Company, a Utah domiciled property and casualty insurer, from the Wasatch-Ohio Group. Effective March 25, 1998, Transunion Casualty Insurance Company was re-named Wasatch Crest Casualty Insurance Company (WCCI). Effective March 27, 1998, Wasatch Fire Insurance Company was merged into Wasatch Crest Casualty Insurance Company (WCCI).

After the "material loss event" The Company continued to participate in a January 1, 2000, formalized cost sharing agreement in which Wasatch Crest Group, Inc. (WCGI) provided labor, work space, equipment, data processing and other mutually agreed upon services to the Company. The agreement allocated costs pursuant to Chapter 22 of the NAIC Manual, "Accounting Practices and Procedures/Life and Accident and Health Companies." The Company agreed to reimburse WCGI for the services, labor, facilities and equipment provided on its behalf.

The Company was placed under supervision on October 16, 2002, due to financial insolvency.

Membership

Policyholders are members of this mutual insurer.

Dividends to Policyholders

During the period of this examination, there were no dividends paid to stockholders.

Management

The following were serving as members of the board of directors at December 31, 2001:

<u>Director</u>	<u>Address</u>
Orrin T. Colby, Jr.	South Salt Lake City, Utah
Floyd A. Petersen	Salt Lake City, Utah
David E. Young	Salt Lake City, Utah

On January 28, 2002, at the annual meeting of the policyholders, the following directors were elected:

Orrin T. Colby Jr.
Floyd A. Petersen
Verl R. Topham
H. Arnold Wagner
David E. Young

Officers serving at December 31, 2001, were as follows:

<u>Officer</u>	<u>Office</u>
Orrin T. Colby Jr., William J. Worsley	Chairman, Chief Executive Officer & President Vice President, Treasurer and Secretary*

*Worsley resigned in January of 2002. Floyd A. Peterson was elected Secretary and Craig D. Burton was elected Assistant Treasurer & Assistant Secretary in 2002.

Conflict of Interest Procedure

The Company provided signed conflict of interest statements as evidence of its written procedure for the disclosure of any conflict of interest or affiliation on the part of its officers and directors.

Corporate Records

A review was made of the corporate records for the period covered by this examination. The minutes reviewed indicated that the deliberation and actions of the various corporate bodies were in compliance with the Utah Insurance Code. The examination report generated by the Utah Insurance Department as of December 31, 1998, was reviewed by the board of directors on August 10, 2000.

Acquisitions, Mergers, Disposals, Dissolutions, and Purchases or Sales through Reinsurance

Effective June 30, 1998, the Company acquired 100% of the Class A and C common stock of WCGI, an investment holding company, in exchange for all of the Company's stock of FCL and WCCI. The Company owned 1.0 million of Class A shares of WCGI or 34% of the voting rights, and 5.3 million of Class C shares, or 33% of the voting rights for a total of 67% of the voting rights. This gave the WCM control of WCGI. The Class B stockholders of WCGI had an option which allowed them on or after the earlier of a "material loss event", or December 31, 2003, to convert their shares into Class D common stock. The Class B stockholders also had the right to require all holders of Class A, B and C common shares to convert all of their shares into Class D shares.

The "material loss event" meant that, commencing on December 31, 1998, a reported cumulative net operating loss in excess of \$3,000,000 by WCGI and its subsidiaries, as calculated on a consolidated basis in accordance with generally accepted accounting principles, applied on a basis consistent with prior years, without giving any effect to realized or unrealized capital gains or losses on the sale of invested assets.

In December 2000, pursuant to a Form A Application approved by the Utah Insurance Commissioner under order dated November 27, 2000, the capital of WCGI was restructured based upon the occurrence of the "material loss event". As a result, WCM relinquished its shares of WCGI, wrote off \$6,426,282 of WCGI common stock and no longer controlled or exercised a vote in WCGI, nor did it any longer participate as a registrant in WCGI Form B filings. The same hearing also approved a surplus fund note of up to \$850,000 to be issued by WCM to WCGI, in exchange for cash, if needed, to bolster the surplus of WCM.

Effective December 31, 2000, the Company entered into an assumptive reinsurance agreement with Electric Mutual Benefit Association (EMBA), for the assumption of all liability and responsibility for the payment of all benefits incurred by EMBA under the Group Accident and Health Insurance Program. Additional comments may be found under the REINSURANCE caption of this report.

Effective April 1, 2001, the Company entered into a 100% quota share agreement with CSE Safeguard Insurance Company, for the cession of the Company's net liability for business produced by Four Corners Insurance Services. Additional comments may be found under the REINSURANCE caption of this report.

Effective June 30, 1999, the Company entered into a 95% quota share agreement with First Continental Life & Accident Insurance Company (FCL), for the cession of the Company's ultimate net

loss for accident and health policies; and a 95% quota share agreement with Wasatch Crest Insurance Company, for the cession of workers compensation policies. Additional comments may be found under the REINSURANCE caption of this report.

In an order dated January 14, 2003, the Utah Insurance Department ordered the Company's acquisition of WCI and to take certain actions to make the reinsurer solvent. This was done in conjunction with the Company's execution of \$15,236,079 surplus note referenced below under the caption Surplus Debentures. The reinsurer became insolvent primarily due to the adverse loss development incurred on a significant block of business.

Surplus Debentures

The Company had no surplus debentures issued, retired or in place as of December 31, 2001. The Company did execute a surplus note on December 30, 2002, in the principal amount of \$15,236,079 to MRIK Group, Inc.

AFFILIATED COMPANIES

As of December 31, 2001, the Company was not a member of a holding company.

FIDELITY BONDS AND OTHER INSURANCE

The Company had a fidelity bond with an aggregate liability of \$1,000,000, subject to a single loss limit of liability of \$1,000,000 and a single loss deductible of \$10,000. The NAIC suggested minimum amount of fidelity insurance for a company of this size was \$300,000 to \$350,000.

The Company also participated in commercial lines, commercial catastrophe, and employment practices liability insurance. The directors and officers were provided a director's and officer's and company reimbursement policy. This policy had a \$100,000 retention each claim. The limit was \$5,000,000. Overlying this policy was an excess director's and officer's and company reimbursement policy.

PENSION, STOCK OWNERSHIP AND INSURANCE PLANS

As of December 31, 2001, the Company had no employees.

STATUTORY DEPOSITS

To comply with the statutes of the various insurance departments, the following securities were on deposit as of December 31, 2001:

<u>Name of State</u>	<u>Par Value</u>	<u>Market Value</u>
Deposits not held for benefits of all policyholders:		
Idaho Department of Insurance	<u>290,000</u>	<u>303,665</u>
Total deposits not held for all policyholders:	<u>\$ 290,000</u>	<u>\$ 303,665</u>
Deposits held for benefits of all policyholders:		
Utah Department of Insurance	<u>3,700,000</u>	<u>3,924,380</u>
Total deposits held for all policyholders:	<u>\$ 3,700,000</u>	<u>\$ 3,924,380</u>
Totals	<u>\$ 3,990,000</u>	<u>\$ 4,228,045</u>

Pursuant to Utah Code Annotated (U.C.A.) § 31A-4-105, the Company was required to maintain a deposit in the amount of its minimum permanent surplus. The Company's minimum permanent surplus was \$1,400,000 as determined by U.C.A. § 31A-5-211(2)(f). The deposits are held at Wells Fargo Bank Trust Group of Idaho and Utah as required by U.C.A. § 31A-2-206(a).

INSURANCE PRODUCTS AND RELATED PRACTICES

Policy Forms and Underwriting Practices

As of December 31, 2001, the Company was authorized to write disability, property, surety, liability, marine and transport, worker's compensation and vehicle liability.

Territory and Plan of Operation

The Company was licensed to do business in the following states: Idaho, Montana, Nevada, Oregon, Utah, Washington and Wyoming. The Company's certificate of authority in the State of Washington was suspended in the year 2000, but was revoked in the year 2002. The certificate of authority was suspended in the State of Idaho in the year 2002. Both suspensions were due to insufficient surplus as regards statutory limitations.

In accordance with the provisions of Utah Code Annotated (U.C.A.) §31A-4-115, the Company filed three "plan of orderly withdrawal" on April 30, 2002. The first plan of withdrawal was facilitated by the Company selling the private passenger and homeowner's policies to Civil Service Employees Insurance Company in April 2001. The withdrawal event will result from Civil Service Employees Insurance Company issuing policies on its paper when the current policy expires. The second plan was filed to inform the Utah Insurance Department of the Company's intent to continue writing travel accident insurance. The third plan of withdrawal was facilitated by the Company's inability to obtain reinsurance coverage for their worker's compensation line of business. The withdrawal event was the result of the non-renewal of policies.

During the examination, the Utah Insurance Department indicated that the Company did not have any appointed agents.

Advertising and Sales Material

The Company provided booklets describing their Crest Choice, Workers' Compensation and Care24 programs but indicated that all other advertising supplies were destroyed. The Company also stated that there were no radio or television ads used between January 1, 1999, and December 31, 2001.

Treatment of Policyholders

There was no procedure manual for the handling of complaints. There was a memo describing the handling of complaints received from policyholders by employees of the Wasatch Crest Group. There were thirty-four (34) complaints received by the Utah Insurance Department.

REINSURANCE

Assumed

Pursuant to an assumption agreement effective December 31, 1994, the Company assumed 100% of the liability for benefits payable under certain workers' compensation policies. The liability from this agreement was included in the financial statement under the caption, "Loss Portfolio Transfer."

The Company had an assumptive reinsurance agreement with Electric Mutual Benefit Association (EMBA), effective December 31, 2000, whereby, the Company assumed all the risk associated with EMBA's Group Accident and Health Insurance Program.

The Company had a 100% assumptive reinsurance agreement with Educators Insurance Company, effective December 31, 1994, whereby, the Company assumed 100% of certain business written by Educators Insurance Company. The reinsurance agreement stated that the assumption was "100% of the benefits on the Included Policies identified in Exhibits A and C." However, the reinsurance agreement did not have the exhibits attached.

Ceded

The Company's group medical risks were reinsured under the terms of two specific excess of loss treaties with American United Life Insurance Company and American National Insurance Company.

The Company's medical expense conversions were reinsured with Celtic Life Insurance Company. Celtic offered conversion coverage to employer groups who are self funded or fully funded with respect to group medical expense plans covering employees and their dependents. The conversion privilege was available to participants whose coverage has terminated. In addition, Celtic agreed to offer conversion coverage to employer groups who have been issued contracts of stop-loss insurance by Great American Reserve Insurance Company and have been reinsured by the Company.

The Company had a 100% quota share agreement with CSE Safeguard Insurance Company, effective April 1, 2001, of the Company's net liability in force at the effective date or issued or renewed on or after the effective date and classified by the Company as Non Standard automobile business produced by Four Corners Insurance Services.

The Company had a quota share agreement with First Continental Life & Accident Insurance Company (FCL), effective June 30, 1999, for 95% of WCM's ultimate net loss for new and renewal accident and health policies becoming effective on or after June 30, 1999; and 95% quota share of the ultimate net loss for all accident and health losses paid after the effective date arising out of any Company's policies issued prior to June 30, 1999.

The Company had a multi-line quota share agreement with FolksAmerica Reinsurance Company, Gerling Global Reinsurance Corporation of America, Motors Insurance Corporation, and The Tokio Marine and Fire Insurance Company, LTD (U.S. Branch). The agreement was effective January 1, 1997, for 80% of WCM's auto physical damage, property business, casualty business other than auto, auto liability, and Michigan PIP. In addition, the agreement covers 80% of the policy issued to Loan Protector General Agency covering the assessments from the California FAIR Plan Association and 60% of the net retained insurance liability of the Company's policy issued to Loan Protector General Agency. The agreement was extended to protect the Company for loss in Excess of Original Policy Limits and Extra Contractual Obligations.

The Company reinsured with General Reinsurance Corporation its workers' compensation risks on a facultative excess basis, for the amount over its retention of \$750,000, up to a limit of \$30,000,000. This coverage did not apply to black lung or pneumoconiosis risks.

The Company ceded the Oregon non-standard automobile business to Insurance Corporation of Hanover, Reliance Reinsurance Corporation, Signet Star Reinsurance Company, and Underwriters Reinsurance Company on an 80% quota share basis. The extra contractual obligations, on losses that were in excess of policy limits, were reinsured with Signet Star Reinsurance Company. The Company's retention was \$250,000 with limits of \$750,000. This treaty was terminated effective October 19th, 1998.

The Company had a first excess of loss agreement, on worker's compensation risks, with Swiss Re America Corporation for any loss in excess of \$250,000 up to \$750,000; a second excess of loss agreement for losses in excess of \$1,000,000 to a limit of \$4,000,000; and a third excess of loss agreement, for losses in excess of \$5,000,000 to a limit of \$45,000,000.

The Company had a multi-line 80% quota-share agreement covering automobile, property and casualty with Swiss Reinsurance America Corporation. Under an extra contractual obligation, the Company retained \$200,000 and ceded the balance up to a limit of \$800,000. This policy was terminated effective January 1, 2001.

The Company had a 50% quota share and excess of loss agreement with Swiss Reinsurance America Corporation, effective March 1, 1999, covering automobile physical damage, bodily injury and property damage on policies written or renewed on or after March 1, 1999, on policies written in Oregon and Utah. The reinsurer's maximum exposure was \$175,000. The excess of loss portion covered the Company up to \$250,000 on automobile liability and \$350,000 on automobile physical damage, with the reinsurer's maximum exposure being \$750,000 on the liability portion and \$650,000 on the physical damage portion. The agreement was terminated effective April 1, 2001.

The Company had a 95% quota share agreement with Wasatch Crest Insurance Company, for new and renewal workers' compensation policies written or assumed on or after June 30, 1999. In addition, the agreement provided for a 95% quota share participation for all workers' compensation losses and loss adjustment expenses paid after the effective date arising out of any policies issue or assumed prior to June 30, 1999.

ACCOUNTS AND RECORDS

The accounts and records of the Company consist of a general ledger, journals, registers, statistical records, and other records normally maintained by a property and casualty insurance company. Most of the records are maintained on a mainframe electronic data processing system. Data from the mainframe is used by the Company to prepare annual and quarterly statement exhibits, schedules, and other financial statements.

A trial balance was extracted from the accrual basis general ledger as of December 31, 2001, and the accounts were reconciled to the Company's filed annual statement. Individual ledger accounts for the years 1999 and 2000 were reconciled individually as deemed necessary.

The Company retained the services of an independent certified public accounting firm to audit its financial and operating records for the 1996, 1997, 1998 and 1999 Annual Statement reporting periods.

Item nine, contained in the general section of the *Annual Statement Instructions* for property and casualty companies promulgated by the National Association of Insurance Commissioners (NAIC), states, "If this report does not contain the information asked for in the blank or are not prepared in accordance with these

instructions, it will not be considered filed.” In addition, Utah Code Annotated (UCA) § 31A-2-202(6) requires that “All information submitted to the commissioner shall be accurate and complete.”

During the review of the Company’s operations, the following record keeping deficiencies were noted:

- The Company did not produce some information requested indicating a deficiency in the segregation of accounting of transactions with its affiliates.
- The number of directors at December 31, 2001, was not in compliance with the articles or bylaws. The situation was corrected with the January 2002 annual meeting of the policyholders.
- The Company listed, as restricted, statutory deposits on the 2001 annual statement with states that did not restrict the deposits.
- The Company was licensed in the State of Nevada, but indicated on the 2001 Annual Statement that they were not licensed.
- The Company incorrectly reported two bonds with an NAIC designation of 1Z.
- The Company did not record two bonds as of the trade date as required by the National Association of Insurance Commissioners’ Statement of Statutory Accounting Principles No. 26.
- Several former board members remained on the signature cards of the Company’s bank accounts as of the examination date. During the examination, John Igoe signed a check written on behalf of the Company when he was no longer an authorized signer.
- The Company was unable to provide reconciliations for four bank accounts. Three of these accounts, which have been closed, have no records to support the respective outstanding checklist. It is recommended that the balances of these outstanding checklists be reclassified as a miscellaneous payable until their disposition can be determined.
- Two bank accounts did not reconcile with the general ledger.
- The Company was unable to provide copies of several premium tax returns.
- Wasatch Crest Group, Inc. did not provide the examination with all of the databases that comprises the accident and health paid claims. The lack of being provided all databases prevented the examination from accurately identifying the direct claims paid for each Company. Additionally the lack of all paid claims information resulted in the examination not being able to reconcile the paid claim databases to the actuarial lag schedule provided to the actuary to determine the incurred but not reported reserves.
- Wasatch Crest Group, Inc. was unable to provide the examination a database from the American Group Administrators, Inc., a third party administrator, that indicated which Company the respective claim belonged to. The examination attempted to identify which

Company a respective claim belonged to by obtaining a sub medical claims register, but was unsuccessful in obtaining the sub medical claims register. The inability to provide records for a specific company does not comply with Utah Code Annotated (UCA) § 31A-2-203(1)(c).

- After several requests Wasatch Crest Group, Inc. was unable to provide the examination with a database, for accident and health claims from an in-house claims processing system, with an incurred date. However, the President of the Company was able to provide the examination with a database that included the incurred date after one request.

FINANCIAL STATEMENTS

The Company's financial condition as of December 31, 2001, and the results of its operations during the twelve months then ended, as determined by examination, are reported in the following financial statements:

Balance Sheet As of December 31, 2001

Summary of Operations – For the Year Ended December 31, 2001

Surplus Account – For the Years 1999 through 2001

Wasatch Crest Mutual Insurance Company
Balance Sheet as of
December 31, 2001

ASSETS

	<u>Amount</u>	<u>Notes</u>
Bonds	\$ 7,364,637	
Cash and short-term investments	1,422,517	
Premiums and agents' balances in course of collection	1,054,367	
Reinsurance recoverables	2,872,636	
Interest income due and accrued	67,987	
Sundry other assets	<u>124,510</u>	
TOTAL ASSETS	<u><u>12,906,654</u></u>	

LIABILITIES, SURPLUS AND OTHER FUNDS

Losses	16,917,818	(1)
Loss adjustment expenses	1,385,227	(1)
Commissions payable, contingent commissions and other similar charges	418,381	
Other expenses	217,999	
Taxes, licenses and fees	267,068	
Unearned premiums	807,495	
Ceded reinsurance premiums payable	653,600	
Amounts withheld or retained by company for accounts of others	955,554	
Provision for reinsurance	86,957	
Loss portfolio transfer reserve	935,974	
TOTAL LIABILITIES	<u><u>22,646,073</u></u>	
Unassigned funds	<u>(9,739,419)</u>	
Surplus as regards policyholders	<u>(9,739,419)</u>	(2)
TOTAL LIABILITIES AND SURPLUS	<u><u>\$12,906,654</u></u>	

Wasatch Crest Mutual Insurance Company
Summary of Operations
for the Year Ended December 31, 2001

UNDERWRITING INCOME

	<u>Amount</u>
Premiums earned	\$ 9,576,749
Deductions:	
Losses incurred	18,972,551
Loss expenses incurred	1,667,341
Other underwriting expenses incurred	<u>2,665,113</u>
Total underwriting deductions	<u>(23,305,005)</u>
Net underwriting gain	<u>(13,728,256)</u>

INVESTMENT INCOME

Net investment income earned	554,039
Net realized capital gains	<u>106,301</u>
Net investment gain	<u>660,340</u>

OTHER INCOME

Aggregate write-ins for miscellaneous income: management fees	<u>456,462</u>
Total other income	<u>456,462</u>
Net income before dividends to policyholders and before federal income	
Tax	(12,611,454)
Dividends to policyholders	<u>-0-</u>
Net income after dividends to policyholders but before federal income taxes	(12,611,454)
Federal income taxes incurred	<u>-0-</u>
Net income	<u><u>\$(12,611,454)</u></u>

Wasatch Crest Mutual Insurance Company
Surplus Account
for the Years 1999 through 2001

	<u>1999</u>	<u>2000</u>	<u>2001</u>
Surplus as regards policyholders, December 31 Prior year	\$ 5,953,691	\$ 5,607,220	\$ 2,884,666
Net income	1,467,895	(6,168,506)	(12,611,454)
Net unrealized capital gains or (losses)	(2,409,015)	3,300,332	
Change in nonadmitted assets	325,617	139,374	20,205
Change in provision for reinsurance	269,032	36,557	(63,146)
Change in excess of statutory reserves over statement reserves		(30,311)	
Cumulative effect of accounting principles			30,310
Change in surplus as regards policyholders for The year	<u>(346,471)</u>	<u>(2,722,554)</u>	<u>(12,624,085)</u>
Surplus as regards policyholders, December 31 Current year	<u>\$ 5,607,220</u>	<u>\$ 2,884,666</u>	<u>\$ (9,739,419)</u>

COMMENTS ON FINANCIAL STATEMENT

(1) Losses and loss adjustment expenses \$23,569,843

The liabilities for losses and loss adjustment expenses reported by the Company were increased by \$17,288,911 in aggregate. The following schedule identifies adjustments made to the specific reserve accounts:

<u>Description</u>	<u>Per</u> <u>Company</u>	<u>Per</u> <u>Examination</u>	<u>Change in</u> <u>Surplus</u> <u>Inc. (Dec.)</u>
Losses	\$6,039,156	\$ 6,778,944	\$ (739,788)
Losses ceded to Wasatch Crest Insurance Company (WCI) which WCI did not have financial capacity to honor		10,138,874	(10,138,874)
Total losses	6,039,156	16,917,818	(10,878,662)
Loss adjustment expenses (LAE)	241,776	503,586	(261,810)
LAE ceded to WCI which WCI did not have financial capacity to honor		881,641	(881,641)
Total LAE	241,776	1,385,227	(1,143,451)
Total changes	\$6,280,932	\$18,303,045	\$(12,022,113)

The \$739,788 and \$261,810 increases in the amounts reported by the Company resulted from adverse loss development in the workers compensation line of business and the amount of auto business losses in excess of the anticipated reinsurance coverage for that business.

An aggregate of \$11,020,515 in losses and LAE ceded to WCI was recognized in addition to \$6,280,913 in losses and LAE reported by the Company. The additional liabilities represented the amount of assumed reserves WCI did not have the financial capacity to satisfy due to the reinsurer's financial insolvency.

(2) Surplus as regards policyholders \$(9,739,419)

The Company's surplus as regards policyholders was determined to be \$12,022,113 less than reported in the Company's annual statement as of December 31, 2001. The following schedule identifies the examination changes:

<u>Description</u>	<u>Annual</u> <u>Statement</u> <u>Dr (Cr)</u>	<u>Per</u> <u>Examination</u>	<u>Change in</u> <u>Surplus</u> <u>Inc. (Dec.)</u>	<u>Notes</u>
Losses	\$6,039,156	\$16,917,818	\$(10,878,662)	(1)
Loss Adjustment Expenses	241,776	1,385,227	(1,143,451)	(1)
Total changes			(12,022,113)	
Surplus as regards policyholders per Company			2,282,694	
Surplus as regards policyholders per Examination			<u>\$ (9,739,419)</u>	

U.C.A. §31A-5-211, requires the Company to maintain permanent surplus in the amount of \$1,400,000. In accordance with U.C.A. 31A-17-VI, the Company reported

total adjusted capital of \$1,711,654, and an authorized control level risk-based capital (RBC) requirement of \$1,223,931 as of December 31, 2001. The examination determined total adjusted capital to be \$(10,310,459).

SUMMARY OF COMMENTS AND RECOMMENDATIONS

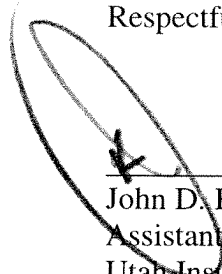
Items of significance or special interest contained in this report are summarized below:

1. During the review of the Company's operations, certain record keeping and information control deficiencies were noted. **(ACCOUNTS AND RECORDS)**
2. An \$11,020,515 portion of a \$16,221,781 credit for losses and LAE ceded to Wasatch Crest Insurance Company (WCI) was not recognized for examination purposes because the assuming insurer was insolvent as of the examination date and did not have the financial capacity to satisfy the assumption. **(COMMENTS ON FINANCIAL STATEMENT – (1) Losses and loss adjustment expenses)**
3. The examination determined total adjusted capital to be \$(10,310,459). In accordance with U.C.A. 31A-17-VI, the Company reported total adjusted capital of \$1,711,654 and an authorized control level risk-based capital (RBC) requirement of \$1,223,931 as of December 31, 2001. U.C.A. §31A-5-211, requires the Company to maintain minimum permanent surplus in the amount of \$1,400,000. **(COMMENTS ON FINANCIAL STATEMENT –(3)Surplus as regards policyholders)**
4. Subsequent events:
 - a. In accordance with the provisions of Utah Code Annotated (U.C.A.) §31A-4-115, the Company filed three “plan of orderly withdrawal” on April 30, 2002. (Territory and Plan of Operation)
 - b. Company was placed under supervision on October 16, 2002. (History)
 - c. MRIK Group, Inc. invested funds in the Company. A surplus contribution note in the amount of \$15,236,079.20 was issued MRIK by the Company in conjunction with the investment. The note was dated December 30, 2002. (Surplus Debentures)
 - d. In an order dated January 14, 2003, the Utah Insurance Department ordered the Company's acquisition of WCI and to take certain actions to make the reinsurer solvent. (Acquisitions, Mergers, Disposals, Dissolutions, and Purchases or Sales through Reinsurance).

CONCLUSION

In addition to the undersigned, Allen J. Hart, CFE, Senior Examiner-Utah, and Faanu Laufiso, Examiner-Utah, Robert C. Murphy, CFE, CIE, FLMI, Examiner-In-Charge, and Taylor-Walker & Associates, Inc.-Actuaries, join the undersigned in acknowledging the cooperation and assistance extended by the representatives of the Company during this examination.

Respectfully submitted,

A handwritten signature in dark ink, appearing to read "John D. Kay", is written over a horizontal line. The signature is enclosed within a large, hand-drawn oval.

John D. Kay, CFE, CIE
Assistant Chief Examiner
Utah Insurance Department